

Structuring and Marketing Build America Bonds

June 19, 2009



STONE &
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San Francisco Los Angeles San Diego New York Chicago Phoenix Richmond Annapolis Big Bear



Build America Bonds

- **What Are Build America Bonds (BABs)?**
 - Taxable bonds with a federal subsidy of 35% of the interest cost
 - Issuer can choose between two types:
 - Direct Payment: issuer receives cash payment over life of bonds
 - Tax Credit: investor received tax credit over life of bonds
 - No volume limit or allocation required
 - Program expires at end of 2010
- **What can be funded?**
 - Tax-exempt eligible capital projects, governmental purposes
 - No private activity: affordable housing, student loans, IDBs, 501(c)3 projects, private use

Two Flavors of BABs

- **Direct Payment BABs**

- Substantial federal subsidy of 35% of the interest cost
- Straightforward bond issuance
- Reasonably developed investor base
- Focus of this presentation

- **Tax Credit BABs**

- Less efficient
 - Investors pay tax on tax credit
 - Complicated calculation of tax benefits over life of bonds
- Smaller investor base
 - Particularly in current economic times
- Eligible for refundings

Initial BABs Structuring Considerations

- **Repayment Security**

- What revenues will be pledged to repayment of BABs?
- Might include general obligation, tax increment, general fund, enterprise revenues, special tax revenues, etc.

- **Application of federal subsidy**

- Pledged directly to pay bond debt service?
- Used as ongoing cash-flow for other purposes?

- **Mechanics of federal payment**

- Issuer must submit request for federal payment every six months
 - At least 45 days (but not more than 90 days) before payment date
 - IRS may streamline payment process in the future

Considerations for Legal Documents

- **Authorization of BABs**

- May add option to authorizing resolutions

- **Treatment of subsidy in legal definitions**

- Recognize federal payment as a revenue or debt service credit?
- Can affect debt coverage calculation

- **Reserve fund sizing**

- Based on gross vs. net debt service

- **Additional bonds test**

- Recognition of subsidy may depend upon outstanding parity debt

- **Timing of payments**

- May be a short timing lag between debt payment and receipt of subsidy



Market-Related Structuring Considerations

- **Call Features**

- “Make whole” call feature limits economic feasibility of future refunding
- “Standard” 10 year par call not popular with taxable investors
- Choice *may* affect interest rate and/or marketability
- Recent sales with par calls at minimal penalty but some investors balking

- **One Series or Multiple Series**

- Can choose all BABs, all tax-exempt bonds or a combination
- Most issuers plan for a combination

- **Timing of Decision on BABs**

- Best made close to time of pricing as market conditions change
- Must allow sufficient time for pre-marketing to investors
- Official designation required before closing

U.S. Bond Markets

- **Total U.S. Bond Market**

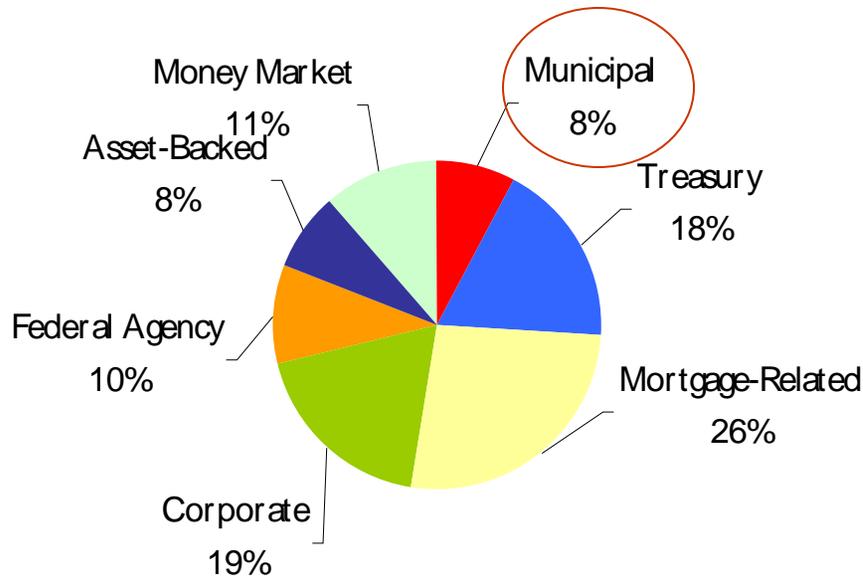
- \$33.5 trillion outstanding
- \$1 trillion avg daily trading volume

- **Municipal Bond Market**

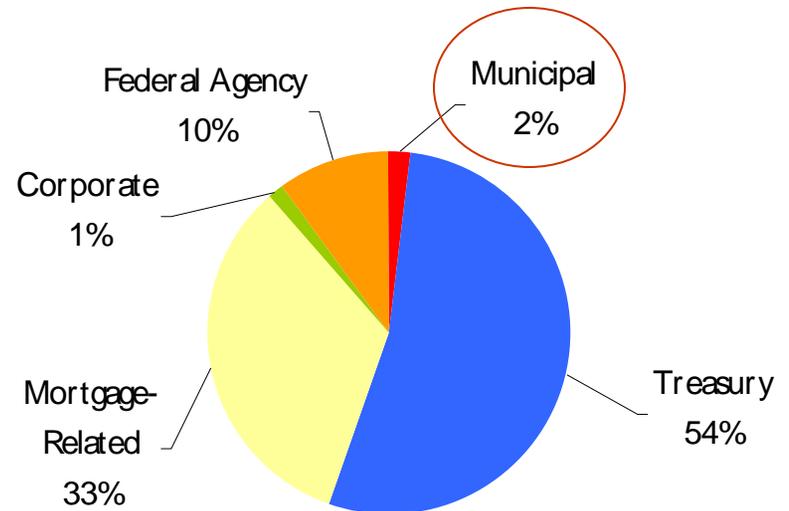
- \$2.6 trillion outstanding (8% of total)
- \$19.2 billion avg daily trading (2% of total)

=> Much less actively traded

**2008 Outstanding Debt
(\$33.5 Trillion)**



**2008 Avg Daily Trading Volume
(\$1.04 Trillion)**



Taxable Markets

- **Market Overview**

- Bonds price at a spread over Treasuries of comparable maturity
- Focus on relative spread versus nominal yield
- Expanded investor audience
 - Bond funds, insurance cos., pension funds, individuals, foreign investors

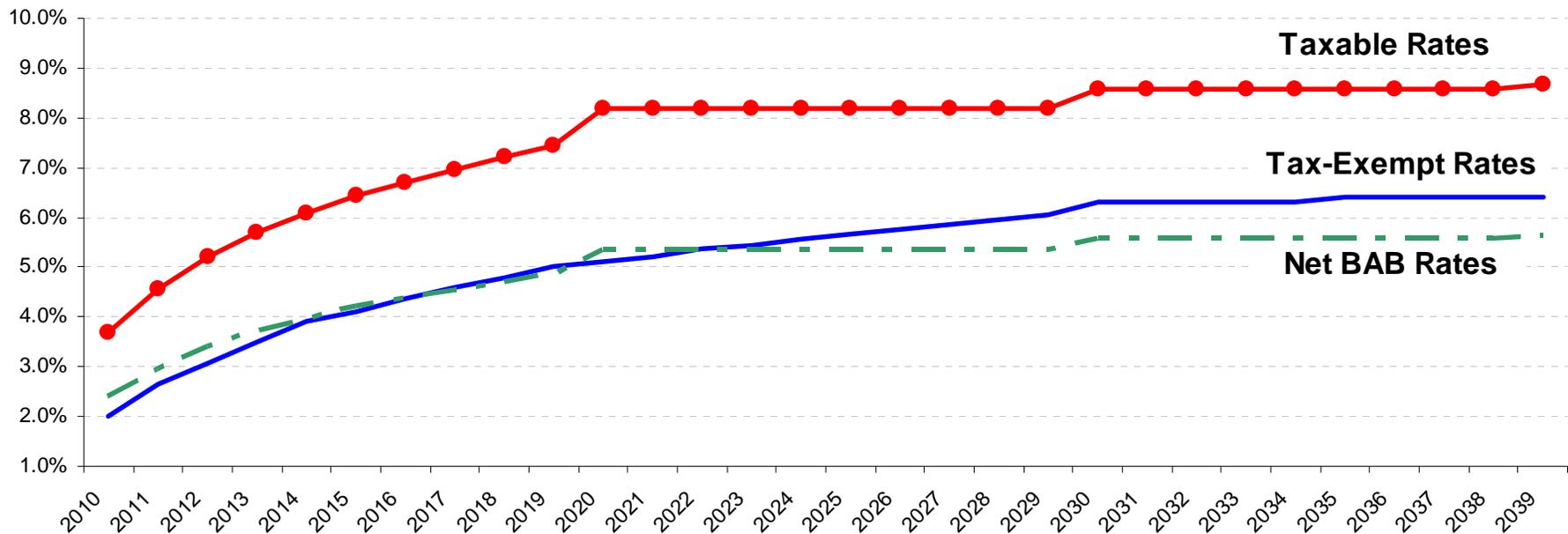
- **Investor Preferences**

- Liquidity
- Highly-rated, well-known names
- Large par amounts
 - > \$250 million meets “index eligible” benchmark for fund performance
- Bullet maturities
- Non-callable debt
 - i.e. make whole calls

Do BABs Make Economic Sense?

- Depends on market conditions at time of pricing
- In current market, likely yes, particularly on longer maturities

Illustrative Rates for an A Rated California Revenue Bond
**** Callable in 10 Years at Par****



Real World BAB Issuance

- **Active issuance since early April ***

- More than 86 issues totaling more than \$12.5 billion

BAB Issuance By Size Through June 11, 2009

	By Par Amount		By # of Issues	
\$1 billion +	\$ 6,375	54%	2	3%
\$500 million to <\$1 billion	1,250	11%	2	3%
\$100 million to <\$500 million	2,488	21%	12	16%
\$50 million to <\$100 million	1,093	9%	17	22%
Less than \$50 million	606	5%	43	57%
	<u>\$ 11,811</u>	<u>100%</u>	<u>76</u>	<u>100%</u>

- **Evolving market conditions**

- First sales: larger par, higher rated, well known issuers, make whole calls,
 - Later sales: tighter spreads, smaller issues, lower ratings, par calls
 - Initial exuberance has diminished

- **Actively quoted secondary market trading**

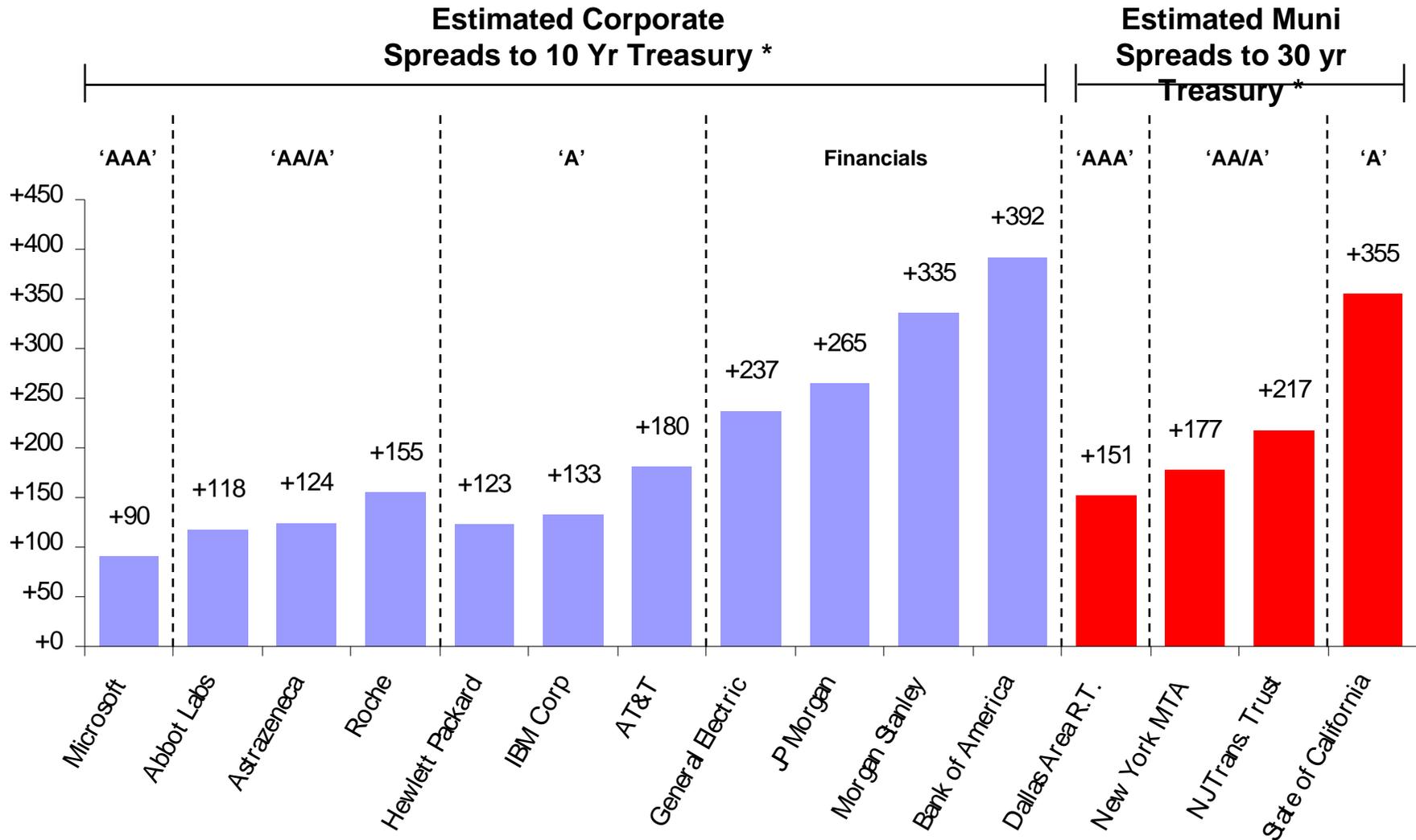
* Source: Thomson Reuters The Bond

Sample Pricing Comparables

Pricing Comparables for Build America Bonds

	4/20/2009	4/22/2009	5/4/2009	6/2/2009	6/4/2009	6/16/2009
Pricing Date	4/20/2009	4/22/2009	5/4/2009	6/2/2009	6/4/2009	6/16/2009
Par Amount	\$1,375,000,000	\$5,233,000,000	\$200,000,000	\$375,000,000	\$78,385,000	\$831,655,000
Issuer	New Jersey Turnpike Authority	State of California	Sacramento Municipal Utility District	San Antonio Electric & Gas	Metropolitan Water District of So. California	Dallas Area Rapid Transit
Ratings	Aaa/AAA/AAA	A2/A/A	A1/A+/A	Aa1/AA/AA+	Aa2/AAA/AA+	Aa3/AAA
Call Provisions	Make whole (UST + 40 bps)	Make whole (UST + 50 bps)	Make whole (UST + 35 bps)	Make whole (UST + 25 bps)	7/1/2019 @ 100	6/1/2019 @ 100 2044: UST + 40 bps
Maturity	2040	2039	2036	2039	2039	2044
30-Year Treasury	3.714%	3.784%	4.072%	4.535%	4.575%	4.499%
Spread	3.700%	3.650%	2.250%	1.450%	1.800%	1.500%
Taxable Yield	7.414%	7.434%	6.322%	5.985%	6.375%	5.999%
Net BAB Yield	4.82%	4.83%	4.11%	3.89%	4.14%	3.90%

Current Taxable Trading Spreads

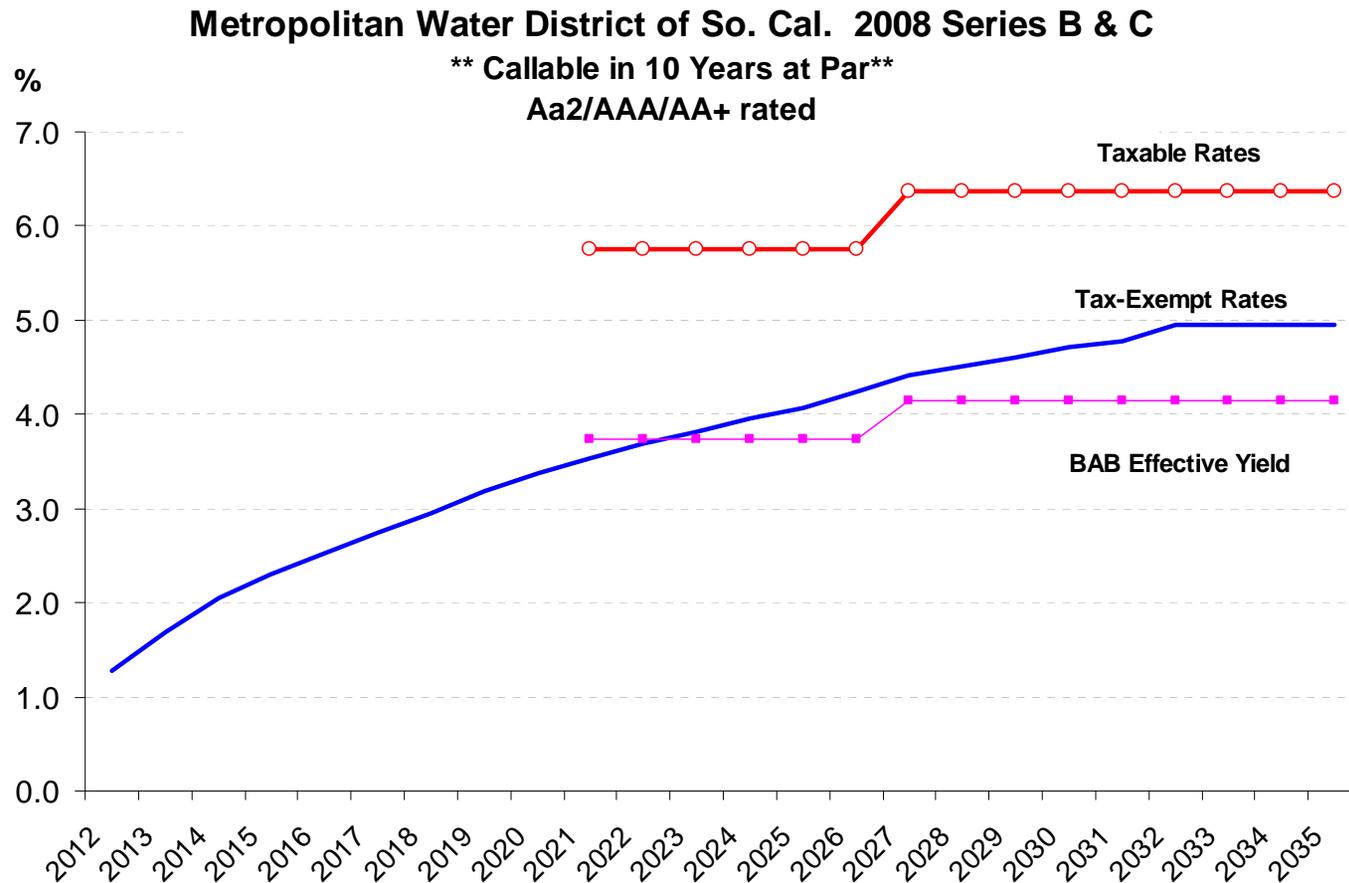


Source: Bloomberg, Stone & Youngberg Trading

*As of Wednesday June 17, 2009

Recent Met Water Sale

- **Metropolitan Water District of So. Cal priced 2 series in early June**
 - \$218 million tax-exempt Series A and \$78 million taxable BABs Series B
 - Wanted to avoid non-callable debt



Recent Smaller BAB Sales

\$12.9 million Brea Water May 14, 2009

- AA- rated
- 10-year par call
- Also a \$12.86 million tax-exempt refunding series
- BABs pricing
 - 2039 maturity
 - Wrapped around Series A
 - +267 over 30 yr Treasury
 - Net yield of 4.39%
- Cashflow Savings
 - ~\$100,000 per year

\$55 million Tulare Wastewater June 17, 2009

- A- rated (Baa1 on parity debt)
- 10-year par call
- FSA insurance for liquidity
- Investors focused on credit
 - Central Valley economy
 - Top 3 dairies > 50% of revenues
 - Default remedies
- BABs pricing
 - 2044 term bond
 - Wrapped around prior debt
 - + 448 to 30 year Treasury
 - Net yield of 5.90%

\$56 million S. Bayside Wastewater June 18, 2009

- AA/A+ rated
- 10-year par call
- Investors focused on price
 - Competition from CA BAB secondary market trades
- Bought by insurance funds, retail, money managers
- BABs pricing
 - Serial bonds through 2019
 - Three term bonds
 - Final 2030 maturity: +348 to 30 year Treasury (5.30% net yield)
 - All in TIC of 5.12%



Bottom Line on BABs

- **Marketing insights**

- Education of taxable investors is ongoing
- Market still developing for lower rated credits

- **Economic value**

- Interest subsidy is significant in current market
- Wide credit spreads in tax-exempt market amplify impact
- Benefit will vary as market conditions change

- **Limited time span**

- Program sunsets December 31, 2010
- Uncertain prospects for future extension

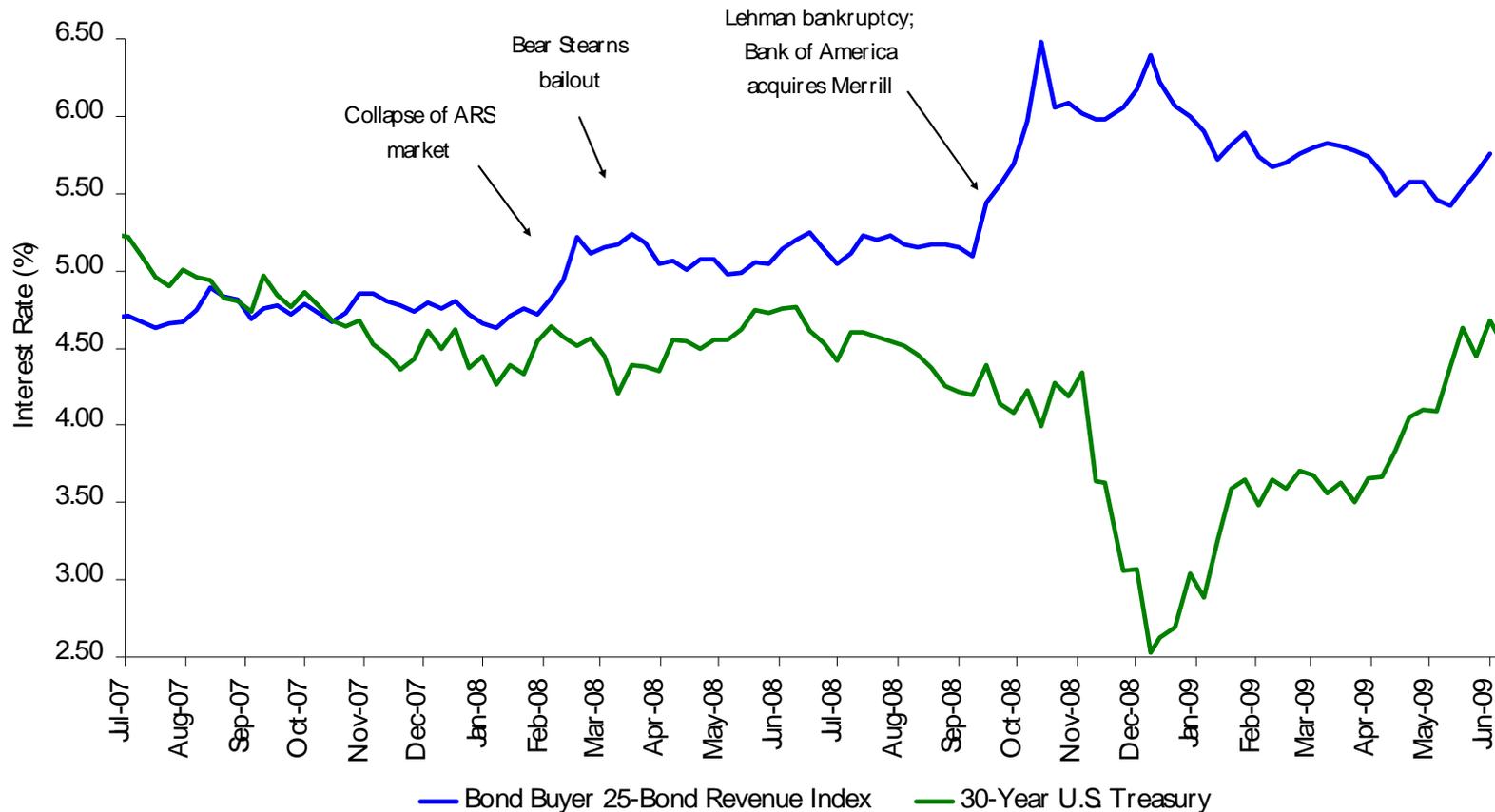
Questions?

- **Contact Information**

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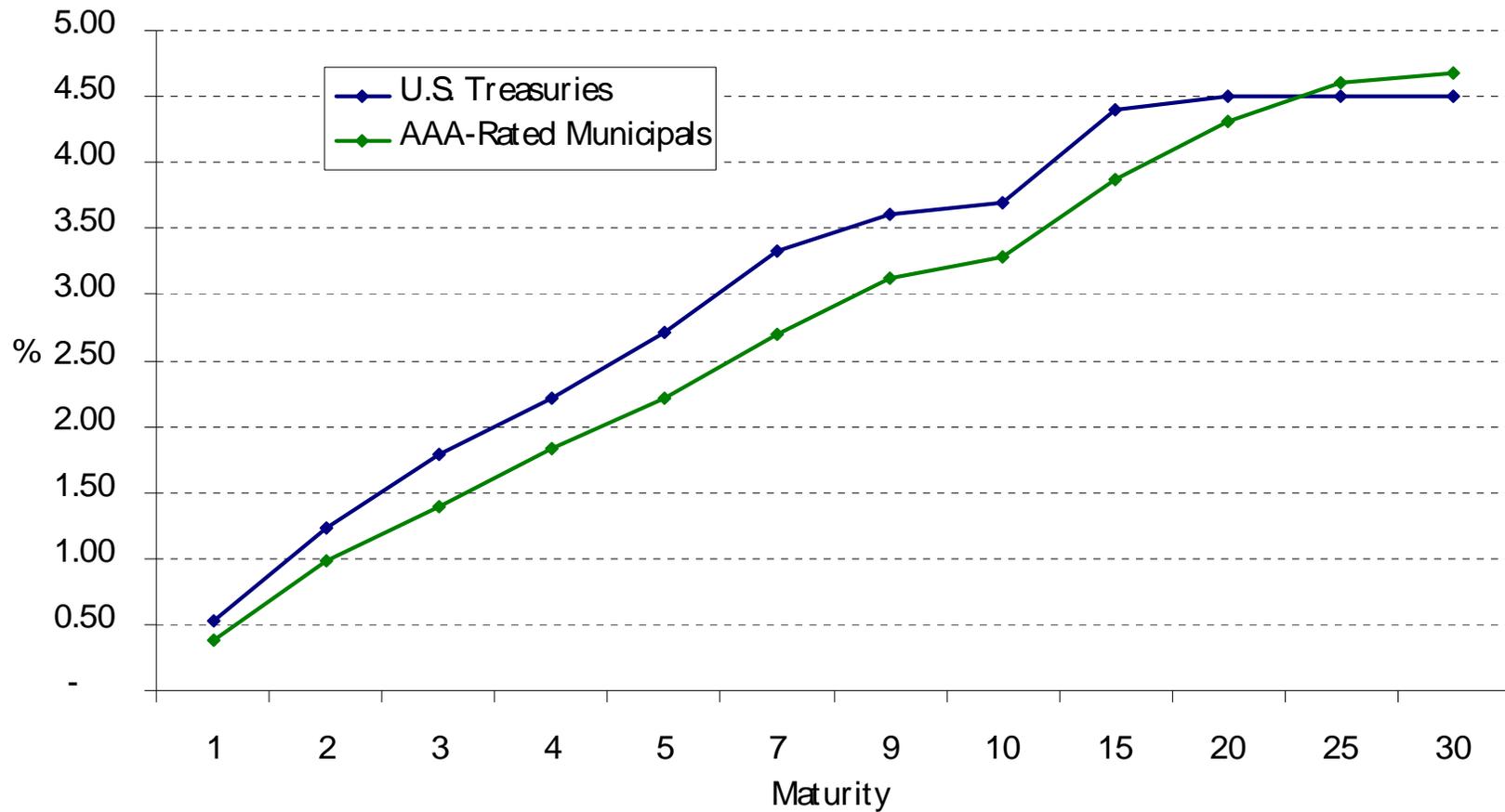
Dynamic Municipal/Treasury Relationship

Bond Buyer 25-Bond Revenue Index v. 30-Year US Treasury (July 2007 - Present)



Current Municipal & Treasury Yield Curves

Treasury vs. AAA-Rated Tax-Exempt Municipal Yield Curves As of June 6/16/2009



Secondary Market Trading In CA BABs

Average State of California BAB Yields vs. 30 Year Treasury Yields

